Ontario's Economic Outlook

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Introduction

This paper reviews the recent performance of the Ontario economy and provides detail on the 1991 economic outlook.

It also provides an analysis of the factors affecting the Ontario economy in the medium term and a forecast for the 1992-94 period.

Ontario's Outlook for 1991: A Summary

Ontario Economic Outlook at a Glance Table 1

	1989	1990	1991
Real Growth (%)	3.2	0.7	0.5
Job Creation (000s)	87	-1	0
Unemployment Rate (%)	5.1	6.1	7.3
CPI Inflation (%)	5.8	4.9	6.1

- Ontario's real Gross Domestic Product (GDP) is expected to rise by only 0.7 per cent in 1990, with declines in real GDP expected in each of the last three quarters.
- Overall growth in 1991 is forecast to be only 0.5 per cent. Output is expected to continue to decline in the first part of 1991, with moderate growth resuming by mid-year.
- The Consumer Price Index is expected to rise by 4.9 per cent in 1990. In the absence of the GST, inflation in 1991 would moderate somewhat below 4.9 per cent, despite higher oil prices. The impact of the GST, however, is to increase CPI inflation for 1991 to 6.1 per cent.
- Total employment is projected to remain static in Ontario at 4.95 million in 1990 and 1991.
- The unemployment rate is forecast to rise from 5.1 per cent in 1989 to 6.1 per cent in 1990 and to 7.3 per cent in 1991.

The External Context: Key Factors

The Ontario economy is heavily dependent on developments in the external environment: most notably interest and exchange rates, oil prices and international economic performance. The sections below review the outlook for these key external factors.

There remains a significant risk of a major war in the Middle East. The outbreak of war would result in a much more severe and protracted downturn. The short term forecast presented in this paper, however, is based on the assumption that there will be no war.

Financial Markets and the Exchange Rate

A key determinant of Ontario's economic performance is the interest rate policy pursued by the Government of Canada. Record high real interest rates, and an unprecedented Canada-U.S. interest rate spread, which resulted in the Canadian dollar reaching a 12-year high this summer, pushed the Ontario economy into a recession in the spring of 1990.

The Bank of Canada is expected to maintain its single-minded pursuit of lower inflation. Consequently, it will maintain a restrictive monetary policy, in an effort to discourage the incorporation of GST and oil price increases into wage settlements. Nevertheless, the slowing in private credit demand and the reduction in underlying inflationary pressures brought about by the recession should permit a gradual decline in short-term interest rates. The chartered banks' prime lending rate is expected to average 12.4 per cent in 1991, compared to an average of 14.2 per cent in 1990.

With lower interest rates and lower oil prices expected over the course of 1991, the Canadian dollar is expected to move down from the 85-88 cents U.S. range in 1990 to the 83-86 cents U.S. range in 1991.

Energy Prices

The world price of oil also has a substantial bearing on the performance of the Ontario economy. An increase of one U.S. dollar per barrel in the world oil price adds $200 million per year to the Ontario oil bill.

International oil prices rose dramatically this fall in response to events in the Middle East. Substantial uncertainty continues to surround the outlook for oil prices in 1991. This forecast assumes that war does not break out in the Middle East and that, as a result, current prices are unsustainable given the absence of serious supply/demand imbalances. Accordingly, world crude oil prices are expected to fall from an average of U.S. $32 per barrel in the fourth quarter of 1990 to U.S. $22 by the end of 1991.

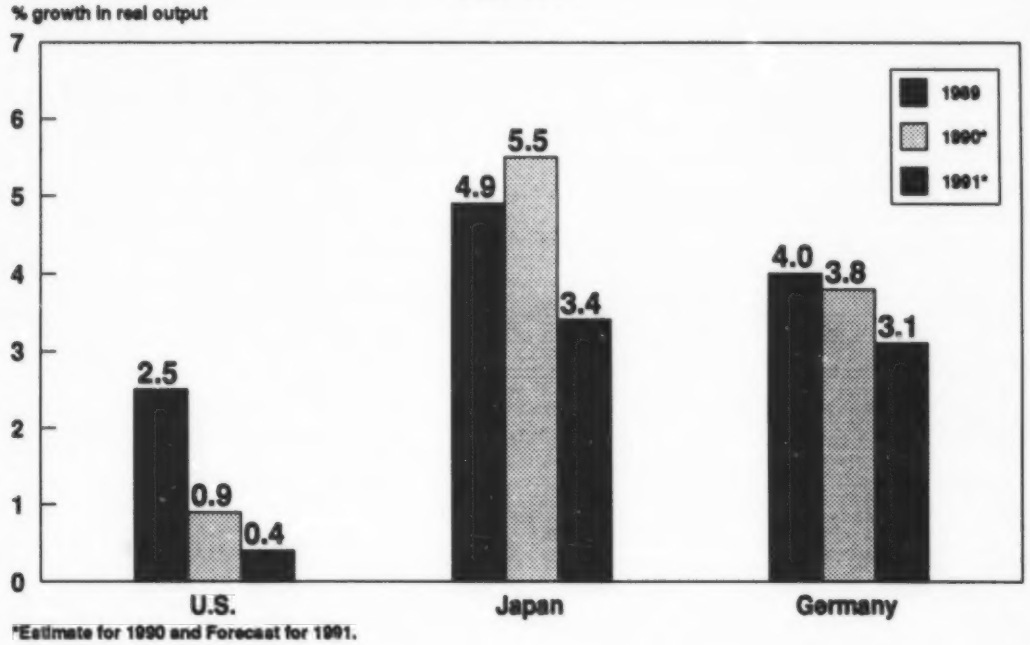
International Outlook

Economic performance in the United States has a significant impact on Ontario. International exports, nearly 90 per cent of which are to the United States, account for 30 per cent of Ontario's GDP. Inter-provincial trade accounts for a further 14 per cent of total provincial output.

Real growth in the Organization for Economic Cooperation and Development (OECD) countries is expected to slow to under 2 per cent in 1991, from 2.5 per cent in 1990 and 3.3 per cent in 1989. However, there will be major differences in economic performance among the industrialized countries.

International Economic Outlook

1989-1991



*Estimate for 1990 and Forecast for 1991.

The U.S. economy is slowing significantly and appears to have entered a recession in the fourth quarter of 1990. Real output in the U.S. is expected to grow by 0.9 per cent in 1990 and 0.4 per cent in 1991, well below the 3.3 per cent average rate recorded over the 1985-89 period. Factors contributing to the downturn include high oil prices, a fall in consumer confidence and high levels of debt. A modest recovery is expected to begin by mid-1991.

West Germany's economy has recorded growth estimated at 3.8 per cent in 1990. In 1991, German growth is expected to be a more moderate 3.1 per cent. Consumption and investment growth will continue to be strong in 1991, due in part to German reunification. The German economy is operating close to full capacity and imports are also expected to continue to grow strongly. The rest of Europe is expected to grow more slowly.

An appreciation of the yen and higher interest rates are expected to slow Japanese growth to 3.4 per cent in 1991, from 5.5 per cent in 1990. While consumption and investment will both grow moderately in 1991, higher interest rates and the decline in the Japanese stock market have resulted in a significant slowdown in investment. Inflation is expected to remain near 3 per cent in 1991 -- high by Japanese standards. This is expected to result in a further tightening of Japanese monetary policy and higher interest rates.

Canadian Outlook

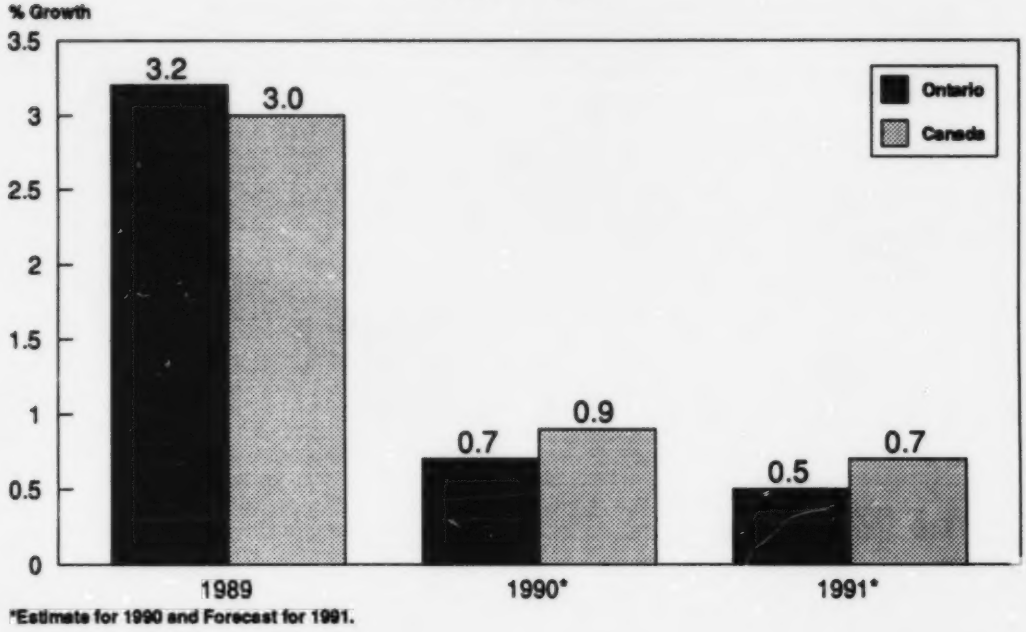
The Canadian economy entered a recession in the second quarter of 1990. The national recession is expected to have the same four-quarter duration as the downturn in the Ontario economy, but the decline in the rest of Canada is expected to be less severe. While growth is expected to show considerable variation among provinces in 1990, most provinces are expected to record weak growth in 1991 as the recession spreads across the country. The Canadian economy is expected to grow by 0.9 per cent in 1990 and 0.7 per cent in 1991.

Employment growth in Canada will slow to 0.9 per cent in 1990 from 2.0 per cent in 1989. In 1991, Canadian employment is expected to remain at 12.6 million. The national unemployment rate is forecast to climb from 7.5 per cent in 1989 to 8.0 per cent in 1990 and to 8.9 per cent in 1991.

CPI inflation will rise to 6.3 per cent in Canada in 1991 from 4.8 per cent in 1990. The GST and higher average oil prices will contribute to this increase.

1991 Outlook in Detail

Real Growth: Ontario and Canada
1989 - 1991



*Estimate for 1990 and Forecast for 1991.

Over the course of the recession, real output is forecast to decline by 1.5 per cent. On an annual basis, real output growth is forecast to slow from 3.2 per cent in 1989 to 0.7 per cent in 1990 and to 0.5 per cent in 1991.

- The downward turn in the major components of domestic demand -- consumption, business investment and housing -- was partially offset by a stronger trade performance in the first half of 1990, as exports grew substantially while imports showed little growth.

Consumer Spending

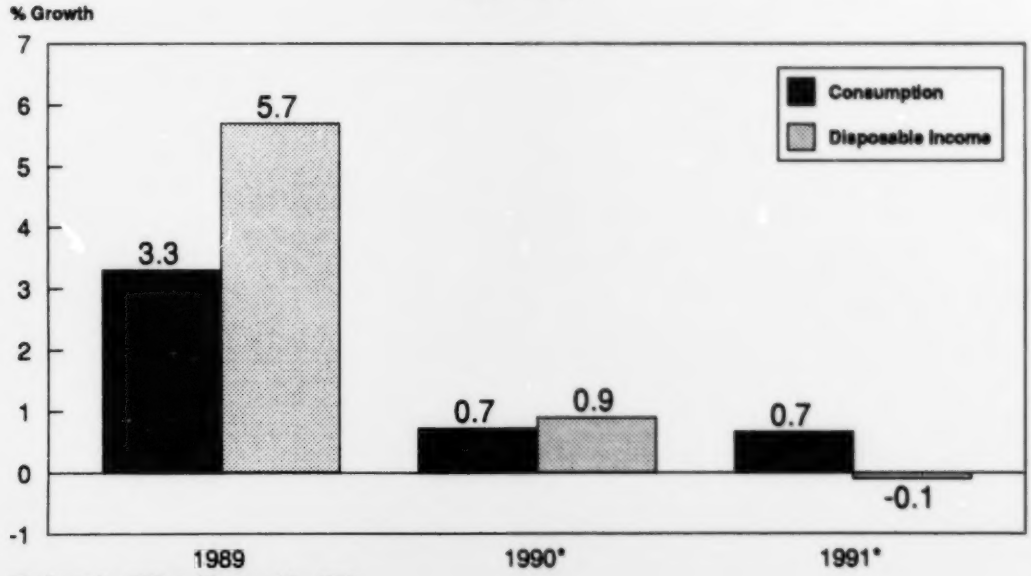
Real consumption is expected to rise by only 0.7 per cent in 1990, compared to 3.3 per cent growth in 1989 and average annual growth of 5.2 per cent from 1983 to 1988.

- Weak spending in 1990, particularly on consumer durables such as automobiles, is a result of a variety of factors. These include high interest rates, declining employment, falling consumer confidence and higher taxes, primarily those announced in the 1989 federal budget.

- Weakness in the housing market, combined with high interest rates, has also led to a decline in sales of household furnishings and appliances.

Real Consumption and Real Personal Disposable Income

1989-1991



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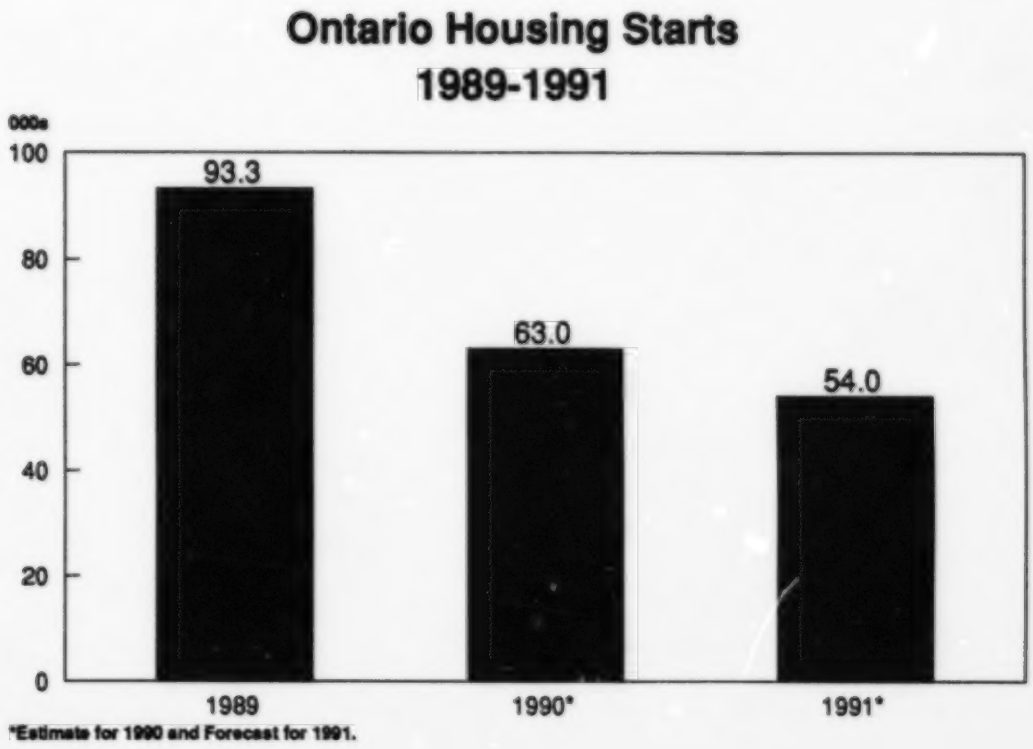
In 1991, weak real income growth, the slump in the housing market and the introduction of the GST will restrain real consumer spending growth to 0.7 per cent.

- The GST will have a particularly negative impact on purchases of services.

- Faced with a decline in real disposable income, consumers are expected to draw down their savings, built up over the last two years, to finance expenditures.

Housing



Housing demand has been weak in 1990 as interest rates rose, employment declined, consumer confidence fell and expectations of further price declines pervaded the market. The weakness in housing market activity also reflects a reversal in net inter-provincial migration and the large inventory of new units, particularly condominiums.

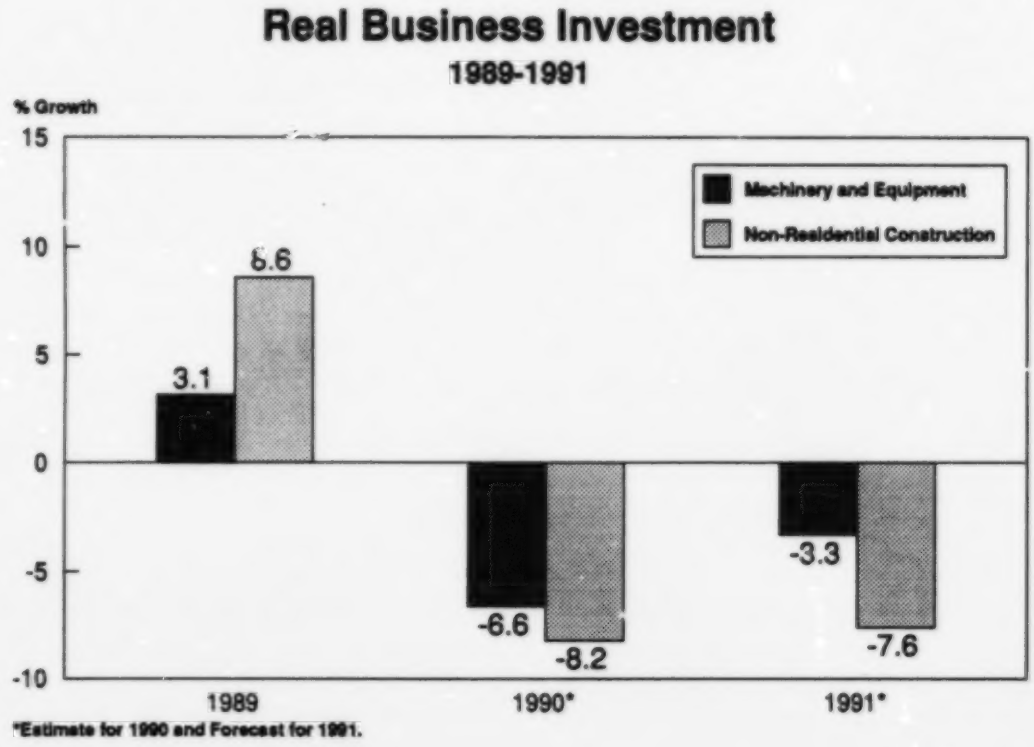
- Housing starts are estimated to total 63,000 in 1990, down from 93,337 starts in 1989. Real residential investment has fallen an estimated 15.1 per cent in 1990.

Housing starts are projected to drop to 54,000 in 1991. Real residential construction spending is expected to decrease by a further 14.6 per cent in 1991, reflecting lower housing starts and weak resale and home renovation markets.

- The GST will negatively impact new home construction, the resale market and renovation activity in 1991.

- Although lower interest rates should provide some relief, declines in real disposable incomes and uncertainty about the economy and the direction of house prices will contribute to the continuing moderation of housing market activity.

Business Investment



Business investment plans have been scaled back sharply in recent months. Real business spending in Ontario has fallen by 7.1 per cent in 1990 and is expected to fall by a further 4.8 per cent to $27.1 billion in 1991.

- High real interest rates, the high dollar and weak consumer spending in both Canada and the United States have produced a sharp drop in corporate profits.

- Spare capacity has emerged in a number of sectors as new plant has come on stream and as the recession in Canada and the U.S. has slowed demand growth.

- Commercial construction is expected to weaken in 1991, in response to higher vacancy rates.

- Non-residential construction is expected to decline by 8.2 per cent in 1990, and by a further 7.6 per cent in 1991.

- Business spending on machinery and equipment has declined by 6.6 per cent in 1990, and is expected to fall a further 3.3 per cent in 1991.

External Trade

In the first half of 1990, Ontario's real external trade surplus increased considerably. Even with declines in the province's real trade balance in the second half of the year, the surplus has improved by $6.7 billion in 1990.

- Ontario real exports are expected to rise by 4.4 per cent in 1990. Stronger auto assembly accounts for a large part of the increase. Ontario's share of North American auto assembly has been increasing steadily due to high capital investment in recent years in transplant and domestic factories.

- With weak consumer spending and declines in investment, real imports are expected to drop by 1.6 per cent in 1990.

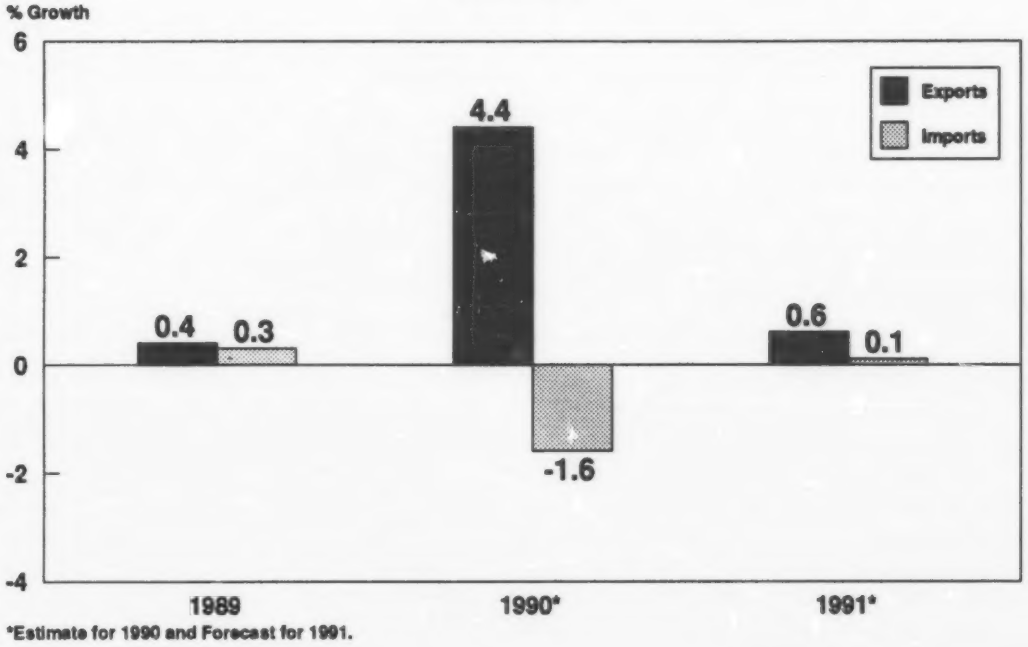
In 1991, Ontario's real trade balance is expected to show only a slight further improvement, as real export growth outpaces the increase in real imports by a small margin.

- In 1991, real exports are expected to post a marginal gain of 0.6 per cent, limited by the slow recovery in the United States and in the rest of Canada.

- Continued weakness in consumer spending and in machinery and equipment investment will keep imports virtually unchanged, rising by only 0.1 per cent in 1991.

Real External Trade

1989-1991



*Estimate for 1990 and Forecast for 1991.

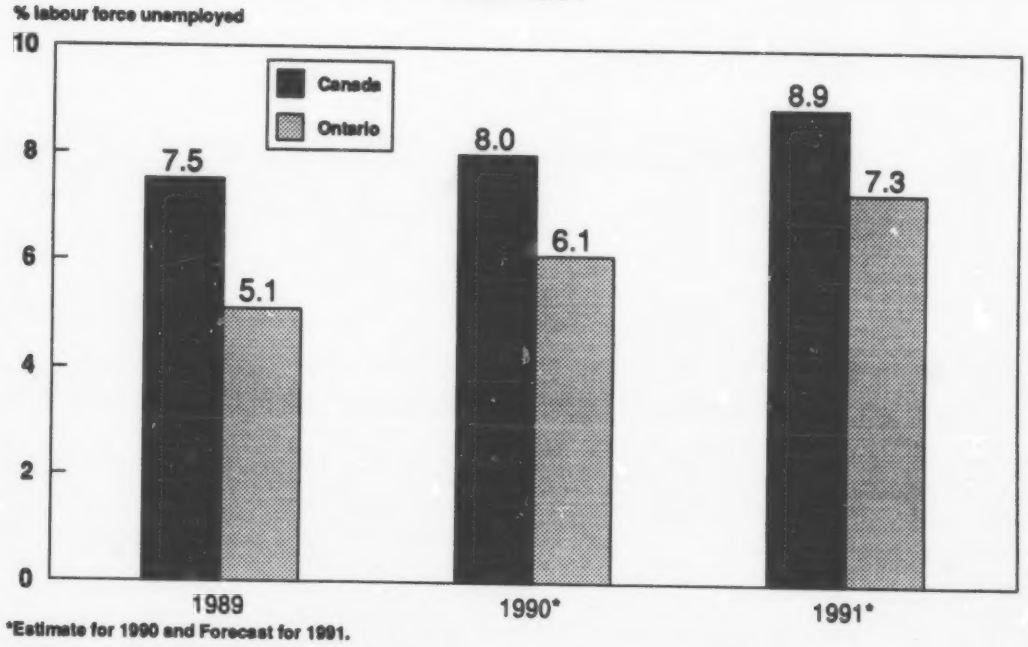
Labour Markets

Total employment, following an increase of 87,000 jobs in 1989, is expected to remain static at 4.95 million in 1990 and 1991. Several factors will contribute to the poor employment performance:

- The recession in the Ontario, Canadian and U.S. economies;
- The high value of the Canadian dollar, which hurts the competitiveness of Ontario's manufacturing exports;
- Structural adjustment pressures from increasing global competition, the Free Trade Agreement and the GST.

Canada and Ontario Unemployment Rates

1989-1991



*Estimate for 1990 and Forecast for 1991.

In 1990, the Ontario unemployment rate is expected to average 6.1 per cent, up from 5.1 per cent in 1989. Unemployment is up substantially among both women and men. As of October 1990, on a seasonally adjusted basis:

- The female unemployment rate has increased to 7.7 per cent from 5.2 per cent one year earlier.

- The male unemployment rate has risen to 6.8 per cent from 4.6 per cent one year earlier.

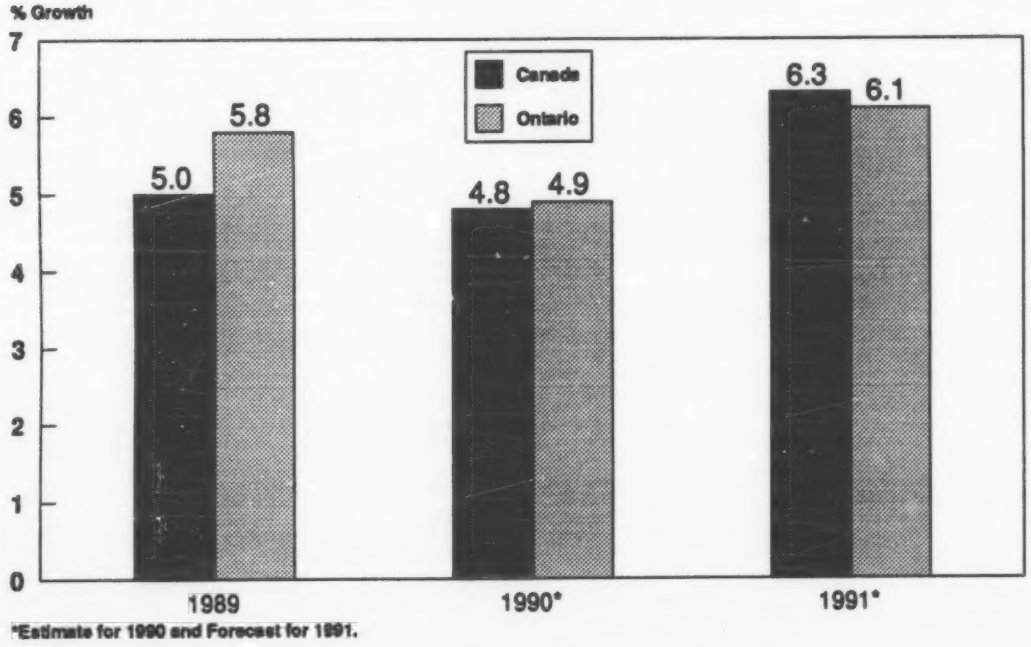
In 1991, the unemployment rate is forecast to average 7.3 per cent. A lower labour force participation rate is expected to moderate the rise in the unemployment rate. Both women and men are expected to face higher unemployment in 1991.

Inflation

In 1990, the Ontario CPI inflation rate is estimated to be 4.9 per cent, down from 5.8 per cent in 1989. The moderation in inflation is attributed to weaker economic activity, a fall in house prices, and lower raw material prices.

Canada and Ontario CPI Inflation Rates

1989-1991



*Estimate for 1990 and Forecast for 1991.

In the absence of the GST, CPI inflation in Ontario in 1991 would drop slightly from its 1990 level, despite higher oil prices. The impact of the GST, however, is to raise Ontario's CPI inflation rate for 1991 to 6.1 per cent. Ontario's inflation rate is expected to be slightly lower than Canada's in 1991, due to Ontario's weaker economy.

Medium-Term Outlook

Key Assumptions

Real interest rates are expected to be held at historically high levels over the medium term, reflecting the Bank of Canada's desire to achieve significant inflation reduction. Although interest rate spreads between Canada and the U.S. are expected to narrow, high real interest rates in Canada will continue to draw in foreign capital. As a result, the dollar is expected to fall only gradually to 81 cents U.S. by 1994, an average annual depreciation of only 1.4 per cent.

The U.S. is expected to grow at an average annual pace of 2.5 per cent over the 1992 to 1994 period. This is markedly slower than the 4.6 per cent annual rate of growth in the three years following the previous recession. Monetary policy in the United States is expected to remain relatively tight over the medium term, as inflation remains a concern. Nevertheless, the Federal Reserve Board is expected to be more moderate than the Bank of Canada in its pursuit of price stability as the U.S. banking situation remains precarious.

Following a surge in 1990 and 1991, real oil prices are expected to remain stable at U.S.$22 per barrel over the medium term.

Outlook

The Ontario Economy: 1992-1994 **Table 2**
(Average Annual)

Real Growth (%)	2.9
CPI Inflation (%)	4.1
Job Creation (000s)	100
Unemployment (%)	6.9

- Over the 1992 to 1994 period, real growth is expected to average 2.9 per cent, significantly slower than the rebound in growth following the last recession. The primary reasons are the continuation of tight monetary policy, the relatively high value of the Canadian dollar and the adjustment costs associated with increased global competition.

- Continued high real interest rates are expected to cause Ontario's CPI inflation rate to fall from 4.6 per cent in 1992 to 3.7 per cent by 1994.

- Following the end of the current recession, the Ontario economy is expected to create an annual average of 100,000 jobs over the 1992-94 period. This compares to annual employment gains of 133,000 during the 1983-88 period. On an annual basis, the unemployment rate is forecast to decline slowly from 7.3 per cent in 1991 to 6.5 per cent in 1994.